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Statement by Mr. Rosen, Ms. Shortino, Ms. Robitaille, and Ms. Senich on Toward an Integrated Policy Framework
(Preliminary)
Executive Board Meeting
September 28, 2020

We thank staff for the extensive report as well as the detailed supplementary materials describing the theoretical and quantitative models. This is important work and will provide useful inputs into future policy discussions on exchange rates, capital flows, and, considerations of the primary tradeoffs in the use of multiple tools. **We note that the current IPF model can serve as a helpful input to the Fund's advice on specific capital flow policies, but we do not believe it should result in a material change to the Institutional View (IV).**

The IPF finds that tools such as capital controls and FX intervention have limited effectiveness, with potential benefits for a narrow set of countries and circumstances -- small open economies with shallow FX markets, deep currency imbalances, and financial frictions. This finding potentially offers helpful insights for Fund advice, but we would like to better understand how staff defines these characteristics. *For example, could staff identify how they would determine whether a country's FX market is "shallow"?* We welcome staff's findings that in countries with deep foreign exchange markets and continuous market access, fully flexible exchange rates are typically optimal, and that capital flow management measures (CFMs) or foreign exchange intervention (FXI) should not prevent exchange rate appreciation to support export industries or be used to combat inflation amid excessive expansionary monetary policy. With this background, it is our understanding that the IPF model would suggest the same optimal policy mix as the standard Mundell-Fleming model for most advanced and many emerging economies. As we and other directors noted in the Board discussion of the IEO report on capital flows, the IV already provides significant flexibility to allow for specific circumstances in which CFMs can have a useful role in limiting capital inflow surges or disruptive capital outflows, and would not expect the IPF findings to contradict the IV.

We encourage staff to continue work on needed safeguards and suitable assessment metrics to minimize the risk of inappropriate use of IPF tools. We echo staff's warning that absent such guardrails, the IPF tools might be used to support misaligned exchange rates, substitute for warranted macroeconomic adjustment, or impede price discovery and competition. We view some of the IPF tools as short-term treatments for the symptoms of monetary policy credibility problems and fiscal weaknesses rather than long-term steps to address the root causes of these problems. We also note that many emerging markets are not small in terms of their role in global trade, and even an economy that is small globally may have regional spillovers that need to be taken into consideration.

We are concerned that the evidence for imposing preemptive CFMs in the framework does not take into account the difficulty policy makers have in weaning off of them. Paragraph 15 describes how macroprudential measures (MPMs) and inflow CFMs, in principle, could be deployed during "normal" times and adjusted over the financial cycle to help insulate domestic aggregate demand from external shocks. While we agree that there is evidence to suggest that adjustment over the cycle and in response to shocks has happened with MPMs, the paper itself notes that CFMs have historically been sticky and do not vary much over time. *Could staff comment on the ability of policy makers to adjust inflow CFMs over the financial cycle?*

In some circumstances foreign exchange intervention during a crisis period could be appropriate, but we do not agree that foreign exchange accumulation is necessarily warranted during "normal times." The context under which authorities may prefer to intervene to accumulate reserves needs to be evaluated. Foreign exchange intervention could make sense when there are strong appreciation pressures on a currency that is already overvalued and where a country's reserve holdings are not excessive. It can be difficult to identify the fundamental forces that are driving the inflows. Therefore, to guide policy advice, it will be important to focus on relevant metrics such as foreign currency mismatches. A track record of repeated foreign exchange intervention also risks undermining monetary policy credibility, as the authorities may be seen as focusing on international export competitiveness rather than overall domestic objectives. The staff report also suggests that repeated interventions lead businesses to build up FX risk, undermining financial stability.

We look forward to hearing updates from future work on operationalizing the framework and on developing safeguards. The Fund should continue to be on the forefront of understanding capital flows, and we believe the IPF is a useful, if limited, addition to considerations when designing the Fund's capital flows policies.